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Scottish Government
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Local Government Finance Circular No 4/2019

By email
To: Directors of Finance of Scottish local authorities
Audit Scotland

Our ref: A23938081
28 March 2019

Dear Director of Finance,

ACCOUNTING FOR CAPITAL RECEIPTS TO FUND QUALIFYING EXPENDITURE ON A TRANSFORMATION PROJECT

Local Government Finance Circular 4/2015 was issued to provide a financial flexibility to a local authority to allow capital receipts to be used to fund severance costs where those costs arise from service redesign, with the design being properly aligned to the delivering on the preventative agenda and engagement with community planning partners. This financial flexibility ceased on 1 April 2018.

COSLA asked Scottish Ministers to extend this financial flexibility. In response Ministers agreed to provide an enhanced financial flexibility to permit the use of capital receipts to fund projects designed to transform service delivery to reduce costs and/or reduce demand, or both. This new flexibility will be available for the financial years 2018-19 to 2021-22.

This circular is also available from the Scottish Government website at:
https://www.gov.scot/policies/local-government/local-government-accounting/

If you have any questions, please do not hesitate to contact me.

Yours faithfully,

Hazel Black

Hazel Black
Head of Local Authority Accounting
Local Government and Analytical Services Division

ACCOUNTING FOR CAPITAL RECEIPTS TO FUND QUALIFYING EXPENDITURE ON A TRANSFORMATION PROJECT

Contents

PART 1
Statutory guidance issued by Scottish Ministers under section 12(2)(b) of the Local Government in Scotland Act 2003 [proper accounting practices]

DEFINITIONS

Local Authority means a council constituted under section 2 of the Local Government etc. (Scotland) Act 1994 (c.39).

General Fund means the fund detailed in section 93(1) of the Local Government (Scotland) Act 1973. The Housing Revenue Account (HRA) is a statutory account forming part of the General Fund which a council may be required to keep in accordance with the Housing (Scotland) Act 1987.

Financial year is a year which commences 1 April and ends 31 March.

Proper accounting practices are as defined in section 12 of the Local Government in Scotland Act 2003.

Accounting Code – the CIPFA-LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

A ***transformation project*** is a project designed to transform service delivery, including through service redesign, in a way that reduces costs and/or demand for services in future financial years.

APPLICATION

1. This statutory guidance applies to the financial years 2018-19 to 2021-22.

PROPER ACCOUNTING PRACTICES

2. Proper accounting practice is varied for capital receipts where a local authority (full council) has approved the use of capital receipts to fund qualifying expenditure on a transformation project. Qualifying expenditure and transformation project are as set out in this guidance. This variation is subject to compliance with the conditions as set out in this guidance.

QUALIFYING EXPENDITURE

3. Qualifying expenditure is non-recurring expenditure on a transformation/ service redesign project where incurring up-front costs will generate on-going savings. This is subject to the following:-

4. To be qualifying expenditure the expenditure must be incurred in the financial years 2018-19 to 2021-22.

5. Qualifying expenditure is expenditure on any transformation or service redesign project, to transform service delivery in a way that reduces costs and/or demand for services in future financial years. It is for each local authority to determine whether their project is a transformation/service redisign project. The key criteria in deciding whether the expenditure is qualifying expenditure is whether the project will generate ongoing savings to that services net revenue expenditure.

6. Qualifying expenditure includes set up and implementation costs of any new processes or arrangements but not the ongoing revenue costs.

7. Examples of transformation projects include, but are not limited to:-

- Setting up a shared back-office or administrative services with one or more other council or public sector bodies;
- Service reform feasibility work e.g. setting up pilot schemes;
- Service redesign – includes for example reconfiguration, restructuring or rationalisation where this leads to ongoing efficiency savings or service transformation
- Expanding the use of digital approaches to the delivery of services or interactions between the local authority and the public;
- Improving systems and processes.

8. Expenditure on severance costs if it relates to a teacher is not qualifying expenditure.

9. Qualifying expenditure for non-teacher severance costs is limited to those costs that:-

- Are directly linked to transformation or service redesign to deliver efficiencies and not reducing costs by just applying cuts to the service; and
- Arise through the application of statute which provides an individual with a right to a payment for redundancy or to the immediate payment of a retirement pension arising from redundancy or business efficiency. Qualifying expenditure is limited to lump sums due either to the individual or the pension fund and not any future recurring payments. Discretionary payments to enhance severance packages is not qualifying expenditure.

ACCOUNTABILITY AND TRANSPARENCY

10. A project has its natural meaning which is a piece of planned work or activity that is completed over a period of time and intended to achieve a particular aim.

11. It is for each local authority to demonstrate that a project qualifies as a transformation or service redesign project. A report is to be presented to full council for approval to use capital receipts to fund, or part-fund, qualifying expenditure on a transformation or service redesign project. The report to full council shall provide details of each transformation or service redesign project to be funded, or part funded, from capital receipts. As a minimum the report shall set out the total estimated cost of each project, the expected savings / service demand reduction to be achieved, details of the types of qualifying expenditure and the amounts and the value of capital receipts the authority plans to use to fund qualifying expenditure. The report may include other matters the authority considers relevant. Approval of full council must be gained before proper accounting practices can be varied.

12. A report, or a revised report, may be presented to full council at any time for approval. The report must include details of all projects, not limited to changes to previously approved projects or new projects. This will ensure transparency and identify the full value of capital receipts to be used to fund qualifying expenditure on transformation or service redesign projects.

13. The report does not need to be a separate document but can be presented as part of the annual budget process or budget monitoring process.

14. From 2019-20, and in each future financial year, the report is to include a commentary on whether planned savings and service transformation/redesign have been/ are being realised in line with the initial estimates. The actual use of capital receipts in prior financial years should be disclosed. This report is to be presented each financial year covering the period the savings have been estimated/ service transformation/redesign is to be achieved.

15. Once approved each report is to made available online to the public free of charge.

ACCOUNTING FOR CAPITAL RECEIPTS

16. Schedule 3 of the 1975 Act places legal restrictions on the use of capital receipts held in the Capital fund / Capital receipts reserve. Proper accounting practices is varied to allow capital receipts, at the point they are recognised, to be transferred to the Capital grants and receipts unapplied account to allow them to be available to fund qualifying expenditure on a transformation or service redesign project.

17. Those capital receipts set aside in the Severance provision statutory adjustment account as at 31 March 2018 may continue to be held to fund qualifying expenditure on transformation or service redesign projects. These capital receipts are to be held in the Capital grants unapplied account, which is to be renamed as the Capital grants and receipts unapplied account. A retrospective restatement is required so that the balance on the Capital grants and receipts unapplied account as at 31 March 2018 is restated to include the capital receipts and renamed at that date.

18. The account should continue to be named the Capital grants and receipts unapplied account until the year that the last capital receipts are used. In the following year it should revert to the Capital grants unapplied account unless it still contains capital receipts for equal pay (see Local Government Finance Circular 1/2019) .

19. The variation to proper accounting practices is available for those Capital receipts recognised in 2018-19, 2019-20, 2020-21 and 2021-22. Capital receipts may be transferred to the Capital grants and receipts unapplied account as a statutory adjustment (as part of the statutory adjustment for gains and losses on the disposal of assets) but only in the same financial year that they are recognised. Capital receipts transferred to the Capital fund/ Capital receipts reserve during this period cannot, in a subsequent financial year, be transferred to the Capital grants and receipts unapplied account. For example, capital receipts transferred to the Capital fund/ Capital receipts reserve in 2018-19 cannot subsequently be moved from the Capital fund / Capital receipts reserve to the Capital grants and receipts unapplied account in 2019-20, 2020-21 or 2021-22.

20. There is no restriction on moving capital receipts from the Capital grants and receipts unapplied account to the Capital fund or Capital receipts reserve. This is a transfer in usable reserves. If a local authority transfers capital receipts from the Capital grants and receipts unapplied account to the Capital fund or Capital receipts reserve they cannot subsequently be transferred back to the Capital grants and receipts unapplied account.

21. The value of capital receipts transferred to the Capital grants and receipts unapplied account in any of the financial years 2018-19, 2019-20, 2020-21 and 2021-22 can exceed the value of qualifying expenditure in the same financial year. This means that capital receipts recognised in the period 2018-2022 can be used to fund qualifying expenditure in the period 2018-2022 and the transfer of capital receipts from the Capital grants and receipts unapplied account to the General Fund /HRA in any financial year may be higher than the qualifying expenditure for that financial year. The statutory reporting requirements set out below require a separate disclosure for any transfer of capital receipts to fund qualifying expenditure in a prior financial year. Over the period 2018-2022 the value of capital receipts transferred from the Capital grants and receipts unapplied account cannot exceed the value of qualifying expenditure over the period 2018-2022.

22. Capital receipts held for qualifying expenditure on a transformation or service redesign project/s may not be used for equal pay.

23. Capital receipts may not be transferred directly to the General Fund / HRA to fund qualifying expenditure. All capital receipts must first be credited to the Capital grants and receipts unapplied account as a statutory adjustment.

24. All unused capital receipts held in the Capital grants and receipts unapplied account which have been set aside to fund qualifying expenditure are to be transferred to the Capital fund / Capital receipts reserve as at 31 March 2022. This is a transfer in usable reserves.

ANNUAL ACCOUNTS – STATUTORY REPORTING REQUIREMENTS

Statutory Adjustments

25. All statutory adjustments are to be reported in the Adjustment between Accounting Basis and Funding Basis section of the Movement in Reserves Statement. The Accounting Code requires an analysis of statutory adjustments either in the Movement in Reserves Statement itself or in a note. The analysis of the statutory adjustments shall clearly identify each of the statutory adjustments made as required or permitted in this guidance.

26. The statutory adjustment for transformation or service redesign projects is:
(a) capital receipts transferred to the Capital grants and receipts unapplied account when an asset is sold.

Capital receipts

27. The transfer of capital receipts held in the Capital grants and receipts unapplied account to either the General Fund / HRA or the Capital Fund / Capital receipts reserve is not a statutory adjustment. This transfer is to be reported in the Transfer to/ (from) other statutory usable reserves section of the Movement in Reserves Statement.

28. An analysis of the reason for each transfer of capital receipts from the Capital grants and receipts unapplied account to the General Fund / HRA or to the Capital fund / Capital receipts reserve shall be made either in the Movement in Reserves Statement itself or in the notes.

29. For the transfer of capital receipts to fund all or part of the qualifying expenditure on a transformation or service redesign project in any financial year the suggested descriptor for the analysis is “Use of capital receipts to fund qualifying expenditure on service transformation or service redesign projects in [state financial year]”. For the transfer of capital receipts to fund qualifying expenditure in a prior financial year the suggested descriptor for the analysis is “Use of capital receipts to fund qualifying expenditure on service transformation or service redesign projects in [state financial year/s]”.

30. As part of the disclosure in the Annual Accounts for the Capital grants and receipts unapplied account a local authority is required to identify, separately, the amount held in that account for capital grants and the amount of capital receipts held for service transformation projects. The amount of capital receipts held for equal pay is to be disclosed separately from those capital receipts held for transformation or service redesign projects. A prior year comparator is required for both equal pay and transformation or service redesign projects.

Scottish Government ***31 March 2019***
Victoria Quay, Leith, Edinburgh EH6 6QQ

PART 2

ACCOUNTING FOR CAPITAL RECEIPTS TO FUND QUALIFYING EXPENDITURE ON A TRANSFORMATION PROJECT

Part 2 of this document gives informal advice only and is not part of the statutory guidance which is contained in Part 1.

BACKGROUND AND COMMENTARY

Power under which the guidance is issued

1. The statutory guidance is issued under section 12(2)(b) of the Local Government in Scotland Act 2003 [proper accounting practices – specified in guidance by Scottish Ministers]. A local authority is required to apply the guidance where the authority has approved the use of capital receipts to fund qualifying expenditure on a transformation project.

2. Where a local authority has not approved the use of capital receipts to fund qualifying expenditure on a transformation project the guidance has no application.

Application

3. The flexibility offered is time limited. It only applies to the financial years 2019-19 to 2021-22. Only capital receipts held in the severance adjustment account at 31 March 2018 and capital receipts received in the period 2018-19 to 2021-22 may be used to fund qualifying expenditure on a transformation project.

4. Any capital receipt held in the Capital fund/ Capital receipts reserve may only be used for the purposes set out in Schedule 3 of the Local Government (Scotland) Act 1975. It is therefore not possible to transfer capital receipts from the Capital fund / Capital receipts reserve to the capital grants and receipts unapplied account.

5. To be available to fund qualifying expenditure on a transformation project a capital receipt must be transferred to the capital grants and receipts unapplied account in the year the capital receipt is received. This is the variation of proper accounting practices i.e. the statutory adjustment. This means that whilst capital receipts received in the financial years 2018-19 to 2021-22 are available to fund qualifying expenditure on a transformation project the decision to transfer the capital receipts to the capital grants and receipts unapplied account must be made in the year the capital receipt is received. It is not possible for a local authority to subsequently decide that a capital receipt received in a prior year is to be made available to fund qualifying expenditure on a transformation project even if that capital receipt was received in the period 2018-22.

6. To provide as much flexibility as possible the guidance allows capital receipts received in any financial year during the period 2018-2022 to be used to fund qualifying expenditure incurred not only in the same or later financial year but also in a previous financial year (subject to any previous year being within the 2018-2022

period). This means that in any financial year during this period the transfer of capital receipts from the Capital grants and receipts unapplied account may be greater than the qualifying expenditure for that year. Over the period 2018-2022 capital receipts transferred to the General Fund / HRA cannot exceed qualifying expenditure for the period 2018-2022.

Accountability and transparency

7. The statutory guidance sets out that full council is required to approve the use of capital receipts. A report to full council is required which sets out, on a project by project basis, details of the project, the costs and savings and the value of capital receipts to be used to fund qualifying expenditure for each project. The guidance does not set any timetable as to when this must be presented to full council but we recommend that this would normally be prior to the start of each financial year and be aligned to the budget setting process. A revised report seeking to change existing projects or to add new projects can be submitted to full council for approval at any time.

Statutory Reporting requirements

8. The statutory reporting requirements are included to ensure that local authorities account for the statutory adjustment in a consistent way and that there is transparency in the use of capital receipts. An analysis of the movements in capital receipts is required to provide that transparency.

Scottish Government
Local Government and Analytical Services Division
March 2019